DLA Piper Global Real Estate Annual State of the Market Survey

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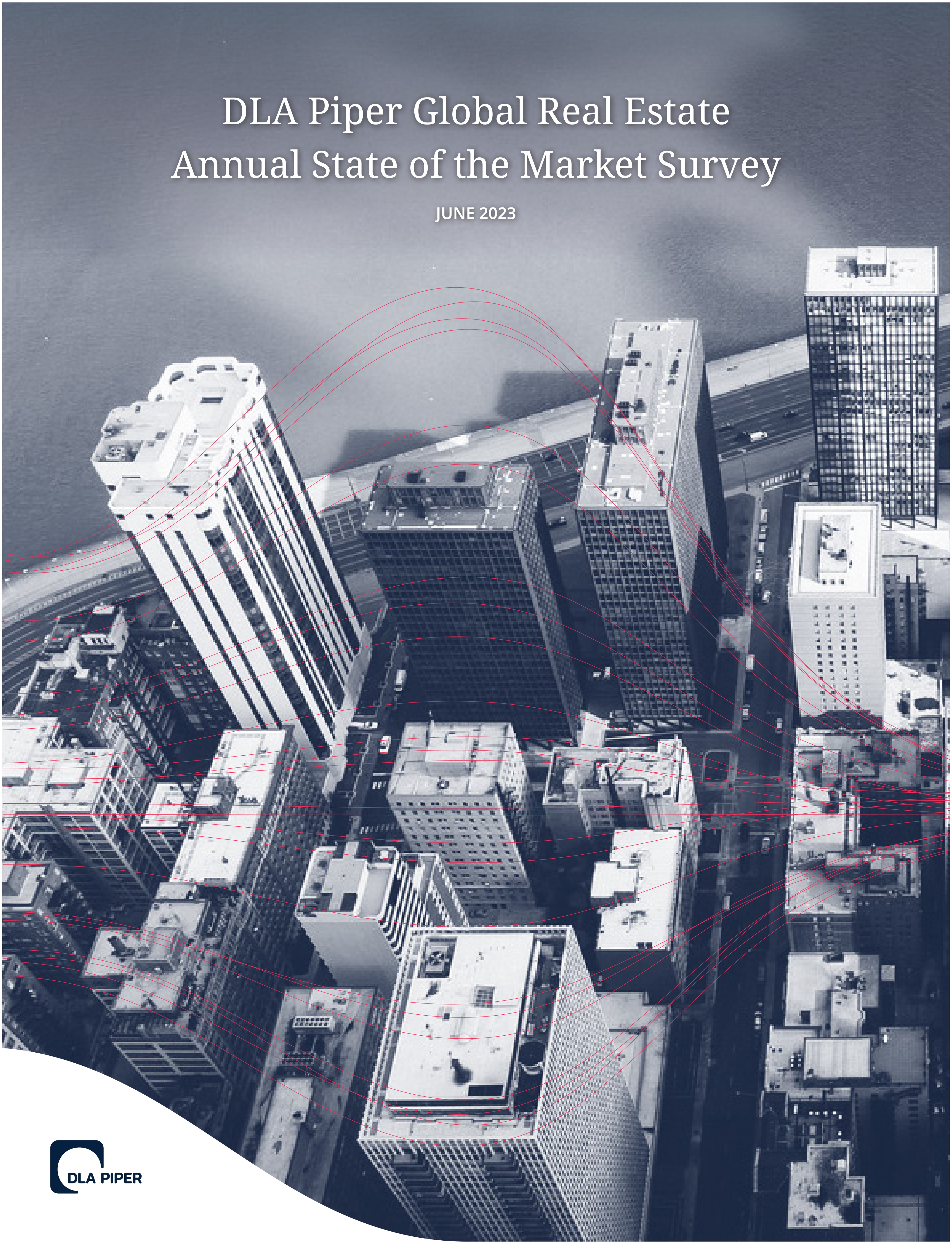

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Executive Summary

As with most investment classes, the impacts of rising interest rates and recession risk have created head-winds and an increase in bearish sentiment among commercial real estate professionals

However, even in this uncertain environment, commercial real estate executives see areas of opportunity.

DLA Piper's 2023 Global Real Estate Annual State of the Market Survey uncovered a fluid landscape in commercial real estate: increasing interest rates, inflation, recession fears, and challenges in many segments of the office sector contributed to a more bearish outlook among respondents than in our prior survey. But respondents also expressed optimism about specific areas of commercial real estate that may offer attractive investment opportunities.

In the 2022 edition of our survey,[1] a wide variety of competing forces – from inflation to supply chain challenges and geopolitical uncertainty – influenced perceptions of the commercial real estate market and its outlook for the year, but respondents generally were bullish. For commercial real estate leaders today, the picture has changed: the Federal Reserve's actions to curb inflation by raising interest rates – and the resulting increased cost of debt – are top of mind and causing concern about the commercial real estate market outlook.

With the exception of the survey that we conducted at the onset of the pandemic, 2023 marks only the second year since 2009 that our report has shown expectations for a bear market. In 2022, respondents overwhelmingly reported feeling bullish about the next 12 months, with that sentiment driven largely by an abundance of capital available and an overall positive outlook on the US economy. In 2023, the tables have turned: eighty-six percent of respondents are bearish about the next 12 months in commercial real estate.

While the impact of economic challenges should not be understated, the rapid recovery from the pandemic outlined in last year's report has somewhat leveled out, as many markets – and societal habits – have stabilized in this "new normal." In 2022, for example, our survey respondents had unresolved questions about the future of office work; in 2023, respondents increasingly believe that the future of offices has fundamentally changed, and the impact of hybrid and remote work may linger for many years to come. In fact, a plurality of respondents now believe office vacancies will "never" return to pre-pandemic levels.

Interestingly, the disruptions in the banking industry that unfolded earlier this year had only a nominal impact on our respondents' perceptions of the state of the commercial real estate market, with no significant change in sentiment among those who responded to our survey before and after those disruptions took place. Many segments of the commercial real estate industry are heavily dependent on regional banks, and the prospect of tighter underwriting standards and/or additional regulation on those banks could pose industry-wide challenges – but survey responses did not suggest that the recent bank failures will have a material adverse impact on the real estate markets.

Despite the evident challenges, there are bright spots across the industry, with respondents noting strong underlying market fundamentals in a number of asset classes including logistics, warehousing, and cold storage, multifamily, and affordable and workforce housing, along with asset types that address basic needs – such as medical offices, grocery-anchored retail, and senior housing.

In all, with the exception of much of the office market, the bearishness in the real estate market reflects general economic headwinds faced by the economy as a whole, and respondents believe that opportunities remain in various segments of the large and diversified commercial real estate market. For those with access to capital, especially investors who are not heavily reliant on debt, there should be attractive investment opportunities despite a challenging economic environment.

A stop to interest rate increases would have the single greatest impact on commercial real estate in the year ahead

Last year, increasing interest rates and inflation were cited in our survey as the top two areas of concern. That was before the Federal Reserve implemented consecutive interest rate hikes and inflation hit a 40-year high.[2]

Despite signs that inflation is slowing, in early May the Federal Reserve announced its 10th straight interest rate hike,[3] raising its benchmark rate by another quarter of a point and hinting at a possible pause in rate increases as early as June. Not surprisingly, our survey found that the concern about interest rate increases has nearly doubled since last year, with its impact on bearishness reaching 46 percent (compared to just 26 percent in 2022). Interest rate changes remain the factor that the largest majority of respondents (98 percent) expect to be most impactful across commercial real estate in 2023, and 92 percent agree that interest rate increases will have a negative impact on investments in commercial real estate this year.

Our survey reveals that commercial real estate decision makers now consider interest rate increases to be a greater concern than inflation. Inflation's role as a driver of bearishness dwindled (6 percent in 2023 as compared to 19 percent in 2022) – yet it remains the third-most cited factor expected to be impactful (89 percent) across the commercial real estate industry.

Even with recent interest rate hikes, most respondents (69 percent) think interest rates will continue to increase slightly in the next 12 months, similar to 2022 results (71 percent). However, more than half (57 percent) say interest rates increases have either already peaked or will peak within the next year, with 40 percent anticipating they'll end within the next two years. Notably, the annual inflation rate eased to 4.9% in April[4] – slightly less than many economists predicted and suggesting a moderation of inflation that could reduce the need for additional rate increases.

An end to interest rate hikes would be the most impactful change that could take place in the short term. The increase and uncertainty of interest rates (67 percent) was a top factor influencing why respondents believe that real estate equity commitments will go down in the next 12 months; resolving that uncertainty and stabilizing rates would significantly stabilize the market and give equity investors, lenders and borrowers greater confidence in their underwriting ability.

While the pandemic created supply chain disruptions, improvements since the pandemic[5] have lessened investors' worries in this regard; 35 percent expect supply chain issues will be impactful this year, down from 89 percent last year. However, 55 percent of investors still expect that labor constraints will be impactful this year, compared to 87 percent last year.

For decision-makers in commercial real estate looking to plan for the year ahead, the leveling off of interest rates should be a welcome change and could create an inflection point for a return to growth across much of the industry.

Cap rate increases spurred by interest rate hikes, rising cost of debt, and impending loan maturities may prompt fallout from recent regional bank failures

Declining values,[6] impending loan maturities, and increased debt expenses are creating stress in some areas of commercial real estate. Understandably, some industry leaders may be concerned that recent regional bank failures will further restrict available debt or increase the cost of debt due to tightening of underwriting standards, limited willingness to lend, or further challenges for smaller and regional banks, many of which are active lenders in the commercial real estate space.

However, the results in this year's survey largely show signs of resilience in the market in the wake of the bank failures, reflecting the overall economic environment rather than a few events. While uncertainty lingers throughout the market, our results remained consistent between those surveyed before versus after the banking failures began – signaling that pre-existing concerns were more impactful on their overall outlook for commercial real estate. Factors that influenced bearishness include interest rate increases (46 percent), reduced debt capital (20 percent), and recession risk (15 percent).

Nonetheless, many people are concerned that the failure of regional banks could create challenges for the commercial real estate industry,[7] even if only by reducing the availability of debt from small to mid-sized banks. This may signal additional hurdles for commercial real estate as a significant amount of debt matures or comes up for renegotiation in the years ahead. However, a recent report by Moody's Analytics[8] contends that the commercial real estate industry's reliance on regional banks has been overstated, noting that regional banks account for only 13.8% of debt on income producing properties. This report also notes that the US commercial debt market is diverse and that, if regional banks cut back on their lending, large banks and various non-bank lenders such as mortgage REITs, life insurance companies, and debt funds could fill the gap.

Challenges in the office sector are creating shifts in plans for development across commercial real estate

As many office workers continue to pursue a hybrid approach or work entirely on a remote basis, many segments of the office market continue to face significant challenges. In the past three years, the way many people work has undergone a paradigm shift. And, despite office occupancy increasing since the early days of the pandemic, many believe that the in-office environment of 2019 may never come back – or may at least look very different.

A large majority of respondents in our survey (72 percent) agree that office occupancy will not materially increase during 2023. In fact, 43 percent of respondents noted they believe office vacancies will never return to pre-pandemic levels, an increase from only 20 percent in last year's survey — showcasing a wider acceptance of what could turn out to be a new normal.

While workers have gradually returned to offices over the past three years, a recent study from Stanford University[9] found that 27 percent of paid full-time days were still worked remotely in early 2023. Similarly, the Partnership for New York City's recent Return to Office survey[10] found that 82 percent of employers surveyed expected a "hybrid" schedule would be their predominant policy in 2023.

These new, increasingly entrenched working habits have materially changed the value of portions of America's office buildings. Many investors, developers, and tenants are now looking at offices the same way they used to look at regional shopping malls. While new, class A office buildings with significant amenities, strong ESG credentials, and other advantages may remain successful and sought-after, older, aging buildings could suffer in the new office paradigm. The vast majority of respondents (82 percent) agree there will continue to be a strong need to repurpose spaces and add amenities in office buildings in 2023. We're already seeing this dichotomy play out – according to Avison Young, net effective rents (NER) for trophy buildings have increased 28.4 percent in New York City since the pandemic, while NER for class A, B, and C properties are all down.

Leaders in business, real estate, and government have also discussed the possibility of a new wave of office-to-residential conversions; one survey respondent noted that "fallout from office distress is creating new opportunities for housing." Those conversions, however, often require significant zoning changes, new regulatory frameworks, and – maybe most significantly – time-consuming and costly construction. In addition, many older office buildings are designed in a way that makes it impractical, or at least very difficult and expensive, to convert them to residential use.[11] While such conversions may offer an interesting opportunity to address housing affordability and supply concerns, bring foot traffic to downtown business districts, and repurpose existing space without building from the ground up, they are not a one-size-fits-all solution for the office sector. Nonetheless, they present an opportunity; more than half (59 percent) of respondents in the 2023 edition of our survey said the redesigning and reimagining of office and commercial spaces would be "impactful."

Government leaders have identified conversions as targets for direct entitlement and financing incentives. Chicago's LaSalle Street Reimagined initiative,[12] as an example, selected several mixed-income residential projects to receive city funding, while San Francisco policymakers have considered incentivizing office to housing conversions.[13]

Investors, property developers, and the entire commercial real estate industry are closely monitoring the office environment. Such fundamental shifts in the way spaces are used are rare, and the pandemic has effectively forced portions of the office market through decades of evolution in a few short years. Reflecting the potential lasting impact of these developments, 63 percent of respondents noted that they believed "office workers who spend less than 50 percent of their time working in office buildings" constituted a "structural change."

These changes are magnified by demographic shifts taking place across the country – people have moved and are continuing to move out of large northern city centers, according to the National Association of Realtors,[14] as remote work becomes more commonplace and spurs a migration toward more suburban areas. The majority (60 percent) of respondents to our 2023 survey believe that the ongoing impacts of the pandemic will have a material, long-term impact on commercial real estate in major urban areas, consistent with 2022 (63 percent). As a result, respondents' sentiment around the top US cities for investment has shifted; last year's top city, Austin, had led the pack at 60 percent – this year, just 39 percent of respondents identified it as a top city, as it fell more in line with others on the list, like Miami (39 percent), Nashville (39 percent), and Raleigh-Durham (37 percent).

While the office market may not be quite as top-of-mind as interest rates and inflation, it continues to significantly influence the post-pandemic outlook for commercial real estate overall.

There are opportunities in a challenging environment

Commercial real estate is a very large, complex, and resilient asset class. Despite the recent challenges, industry leaders who responded to our survey identified a number of asset classes that they believe are well-positioned for long term success.

Several notable sources of stability exist. There are vast amounts of capital available to be deployed into real estate investments, with record amounts of capital having been raised recently by real estate private equity funds.[15] Institutional investors continue to allocate a portion of their investments to real estate. The fundamentals for many property types remain strong, and debt levels are generally lower than in past cycles. In fact, “strong fundamentals across assets classes” was the number-one reason that bullish respondents cited for their optimism, increasing from 20 percent in 2022 to 37 percent this year. There are signs that investors are turning toward stable, safe assets amid uncertainty, and these results suggest that they are confident in the underlying strength of those asset classes.

Many of the asset classes respondents identified this year as the most attractive, risk-adjusted opportunities in comparison to 2022 reflect properties that serve basic human necessities. Medical offices rose from 28 percent in 2022 to 37 percent, grocery-anchored retail rose from 22 percent to 27 percent, and senior housing rose significantly from 13 percent to 25 percent. This suggests that many commercial real estate leaders see these asset classes as opportunities in the coming year, even amid uncertainty and challenges in other sectors.

Some of the asset classes identified by survey respondents as presenting attractive investment opportunities are already trending upward. Medical real estate development is on the rise,[16] with record-high rents and demand outpacing supply in the sector. Grocery-anchored retail had a record year in 2022,[17] with transactions totaling nearly $15 billion. Investors in senior housing see stability in the market, with nearly 9 in 10 saying[18] they’d increase or maintain their current exposure to the sector.

Developers are also increasingly building these types of assets outside of traditional CBD areas.[19] As people spend less time in offices and more time at home, they’re looking for essential services like doctors’ offices, grocery stores, and more to be located nearer to residential areas. Where people are spending their time has changed, but their desire for convenience and easy access to the services they need has not. As more people spend at least some time working from home, retail stores, restaurants, food delivery services, bars, gyms, and similar service-oriented establishments in residential areas of cities such as New York, Los Angeles, and Chicago are thriving. In Manhattan’s Greenwich Village, median housing rent was 30 percent higher in April of 2023 than it was in April of 2019.[20]

Multifamily housing remains near the top of the list of attractive investment opportunities in our survey – second only to logistics, warehousing, and cold storage – though it’s viewed as less of an opportunity than it was in 2022. Interestingly, it decreased by roughly the same percentage (down 12 percentage points since 2022) that affordable and workforce housing increased (up 11 percentage points since 2022), further signaling a shift toward development planning that aims to address basic needs. And the need for affordable housing clearly exists – to fully address the affordable housing crisis, the National Low Income Housing Coalition reports[21] that 6.8 million additional affordable housing units are needed for extremely low-income families.

Other opportunities identified by respondents have risen on the list since 2022, including hotels and lodging (14 percent in 2023, doubled from 2022) and student housing (22 percent in 2023, up 12 percentage points from 2022).

Some real estate investment opportunities may also be shifting in favor of investors who are relatively conservative and/or use limited or no debt. When interest rates were at historic lows and debt was plentiful, there was fierce competition for deals.[22] In that type of market, investors who use no debt or low levels of debt – many of whom also have tighter underwriting standards – were frequently priced out of deals. Now, as the pendulum swings back, higher interest rates and more stringent loan underwriting standards may work to the advantage of well capitalized and somewhat more conservative investors.

Despite uncertainty, there is reason for optimism in 2023 – and rewards for careful and targeted investment

With the exception of a relatively brief pandemic-induced pause, the commercial real estate market has benefited from a long period of economic growth, historically low interest rates, and low inflation. Those halcyon days have ended, and the industry now faces challenges such as increasing interest rates, slower growth, and inflation. Despite these challenges, our survey found that decision-makers across the industry believe that there are investment opportunities in asset classes that have solid fundamentals and secular tailwinds, especially those that service human necessities, such as medical office, grocery-anchored retail, and housing.

Highlights of the State of the Market Survey

- In the 2023 report, 86 percent of respondents are bearish about the next 12 months in commercial real estate. This number stands in contrast to the sentiment in our 2022 report, when about 73 percent of respondents were bullish, which was consistent with the 2021 results. More than half of respondents (51 percent) ranked their bearishness at either 3 or 4, on a scale where 1 is the most bearish and 10 is the most bullish.

- The number one reason reported for this bearishness is interest rate increases (46 percent, as compared to just 26 percent in 2022), followed by reduced debt availability (20 percent), recession risk (15 percent), and long-term effects of work-from-home (9 percent). On the other hand, there were bullish sentiments driven by the belief that there are strong fundamentals in many asset classes, which was up 17 percentage points from last year (37 percent of respondents in 2023 versus 20 percent in 2022). Eleven percent of respondents identified confidence in the US economic outlook as a reason for their bullishness. Last year, the top reason for bullishness was an abundance of capital, coming in at 52 percent; that number dropped significantly in the 2023 report, accounting for just 16 percent of bullish respondents.

- Interest rates ranked as the factor that will be most impactful on the commercial real estate market, with 98 percent indicating it will be impactful (up from 76 percent in 2022). Predictions about the movement of interest rates shifted; 78 percent of respondents expect that interest rates will increase over the next 12 months, down from 99 percent in 2022. Last year, just one percent of respondents expected interest rates to drop; now, that number is 16 percent. More than half (56 percent) believe that interest rates have already peaked or will peak within less than a year, with another 40 percent expecting that they will peak within two years. An overwhelming majority (92 percent) of respondents also expect that increasing interest rates will have a negative impact on commercial real estate investment in 2023, more than double the 42 percent who felt the same last year.

- Interest rates aren't the only issue expected to impact the commercial real estate market this year. Challenges in refinancing debt are also a significant consideration, with 98 percent indicating this will be impactful. Roughly $270 billion of commercial real estate loans reach maturity in 2023, according to Trepp, and many of these loans will need to be refinanced at higher interest rates. Still, experts from organizations like Moody's have expressed a belief that a true crash may never come, treating this as a "typical down cycle." Respondents also expect impacts from inflation (89 percent), redesign/reimagining of the use of office space and other commercial spaces (59 percent), and demographic/population shifts among regions (56 percent). Factors expected to be less impactful were PropTech, with just 17 percent expecting it to influence the market, as well as healthy workplaces and wellness initiatives (17 percent), an increased focus on ESG and sustainability (30 percent, down from 45 percent in 2022), and autonomous vehicles and drone deliveries (3 percent).

- When looking at which factors will have the greatest impact on the global commercial real estate market, interest rates are rated as the biggest factor among respondents (83 percent), followed by the US economic outlook (46 percent, up 7 percentage points from 2022), and inflation (45 percent). Global political instability is far less of a concern, falling from 64 percent in 2022 to just 25 percent in this year's report.

- Most respondents – 83 percent – expect that capitalization rates will go up in the next 12 months. Relatedly, repricing and recapitalization opportunities were the second most-cited reason for optimism at 32 percent, behind only strong fundamentals in many asset classes.

- Real estate equity commitments will go down in the next 12 months, according to 71 percent of respondents. In comparison, 13 percent anticipate no change in real estate equity commitments in the year ahead. Of those who expect commitments to decline, most attributed that change to the increase of and uncertainty around interest rates (67 percent) or an uncertain or negative economic outlook (67 percent). Others cited inflation concerns (42 percent), decreased attractive equity investment opportunities (41 percent), and decreased amounts of available investment capital (37 percent). The latter was also the primary reason cited by 53 percent of those who expect no change in real estate equity commitments. Of the 16 percent who forecast that equity commitments will go up, most (70 percent) cited large amounts of available investment capital and the anticipated stabilization of interest rates (65 percent).

- Similar to 2022, the logistics, warehousing, and cold storage group was the top asset class among respondents when asked which classes present the most attractive, risk-adjusted opportunities in the US for real estate investors over the next 12 months. However, the percentage of respondents who identified these assets as the top asset classes diminished (53 percent in 2023 as compared to 66 percent in 2022), as respondents' sentiments were more evenly spread across other asset classes. Multifamily remained second on the list (45 percent in 2023 versus 57 percent in 2022), followed by affordable and workforce housing (38 percent), medical offices (37 percent), and life science and biotech (34 percent). Notably, the perceived opportunity in life science and biotech related real estate fell significantly, dropping 22 percentage points compared to 2022, when it was identified as the third-ranked opportunity.

- When looking at trends in office occupancy, 72 percent of respondents expect that office occupancy will not materially increase during 2023, and 82 percent believe that there will continue to be a strong need to repurpose spaces and add amenities in office buildings. Nearly two-thirds (63 percent) believe that structural changes in the CRE industry will include office workers who spend less than 50 percent of their time working in office buildings, and 58 percent believe that 50 percent of workers in urban areas will return to their offices on a consistent basis over the next 12 months. This is consistent with sentiment in 2022. Significantly more respondents (43 percent) now believe US office building vacancies will never return to pre-pandemic levels, as compared to 2022 (20 percent). Perceived opportunities in the office sector has hit an all-time low, with only 4 percent expecting opportunities in the suburban office market and 2 percent expecting opportunities in the downtown office market.
- In looking at the top US cities for investment during the next 12 months, responses were also more evenly distributed across the top cities. Austin held the top spot yet again, cited by 39 percent of this year's respondents; a notable drop from 2022, when 60 percent of respondents felt it was the top US city for investment. Miami moved into the second spot at 39 percent (up from 27 percent in 2022), while Nashville held steady – also at 39 percent – and Raleigh-Durham dropped 5 percentage points, accounting for 37 percent of this year's responses.
- In the international market, investors from Gulf countries like the UAE, Qatar, and Kuwait are expected to be the most active in the US commercial real estate market, cited by 65 percent of respondents (a 21 percentage-point jump from 2022). Canada, which was expected to be the most active investor in the US market last year at 55 percent, accounted for just 37 percent this year, while Germany fell from 54 percent to 26 percent. London remained the most attractive city for international investments, but fell slightly to 47 percent, while other cities across Europe like Paris, Madrid, and Brussels also saw a drop.

Verbatims

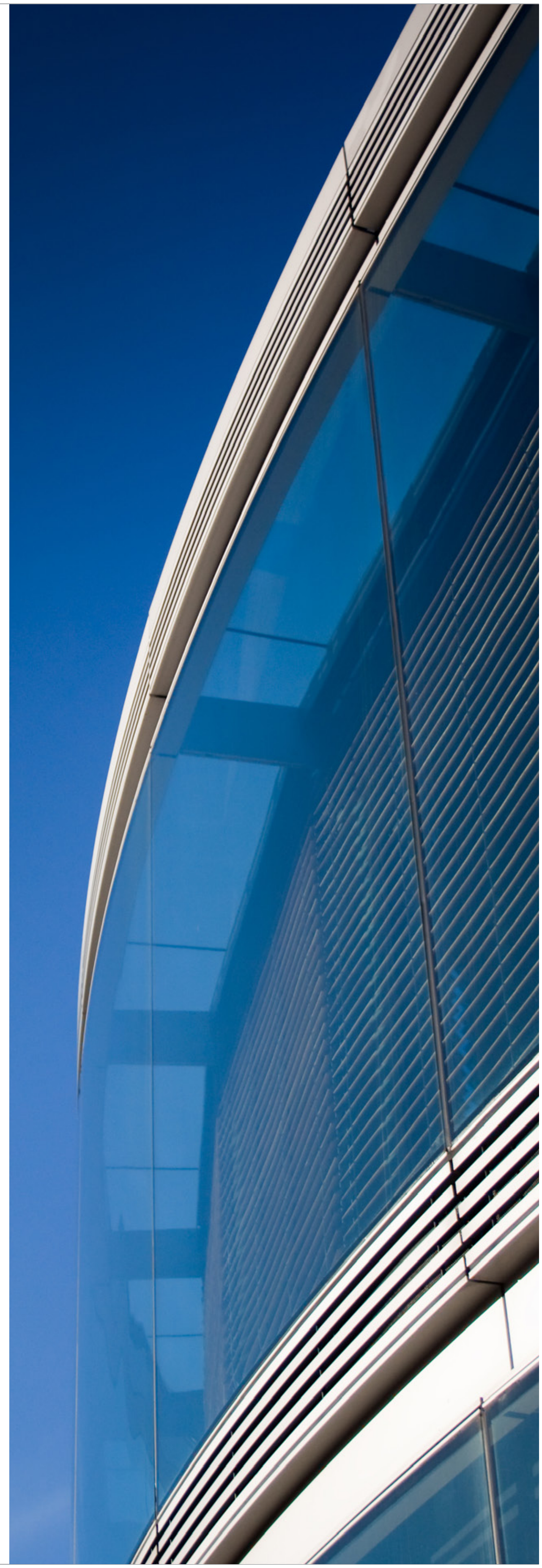
What are you most excited about in the next 12 months when it comes to the commercial real estate market?

- Re-domestication of US supply chain is a focus.
- I think there will be more distress as the year progresses, which will certainly create some buying opportunities, particularly for equity players. I also think the Fed will taper off its rate increases by the end of the year, which should usher in some long-overdue confidence and hopefully re-engage liquidity in the markets.
- Interest rate increases will cause cracks in the system, causing repricing across the board and a buying opportunity for next-generation sponsors with limited legacy issues.
- Continued good health of the multifamily market.
- Opportunities to buy or restructure troubled assets.
- Fallout from office distress to create new opportunities for housing.
- Retail real estate's strong fundamentals and risk-adjusted returns are again making it a desirable asset class.
- Capital markets opening back up and transaction beginning to happen again.
- Prospects of a recession, which may tip leverage to employers instead of employees.
- As a developer, I believe there may be opportunities to buy land and more favorable construction pricing.
- The continued demand for rental housing, as our nation has a housing shortage – which will only be exacerbated by rising rates hindering new projects.
- A slight reduction in construction costs and acquisition costs is top of mind.
- Supermarket-anchored community shopping centers will be key.
- There will be a gradual recovery in sentiment by early 2024.
- There is still lots of capital in the market.
- This will be a period where investors/sponsors/developers are forced to be creative. Excited to see where that takes us.
- Further distance from the worst of the pandemic leading to more consistent demand in a variety of sectors as more and more behavior returns to "normal," as well as further reduction of supply-chain constraints that were driven by the pandemic affected real estate in many ways.
- Solid fundamentals in most asset classes and some market cooling should lead to good buying opportunities.

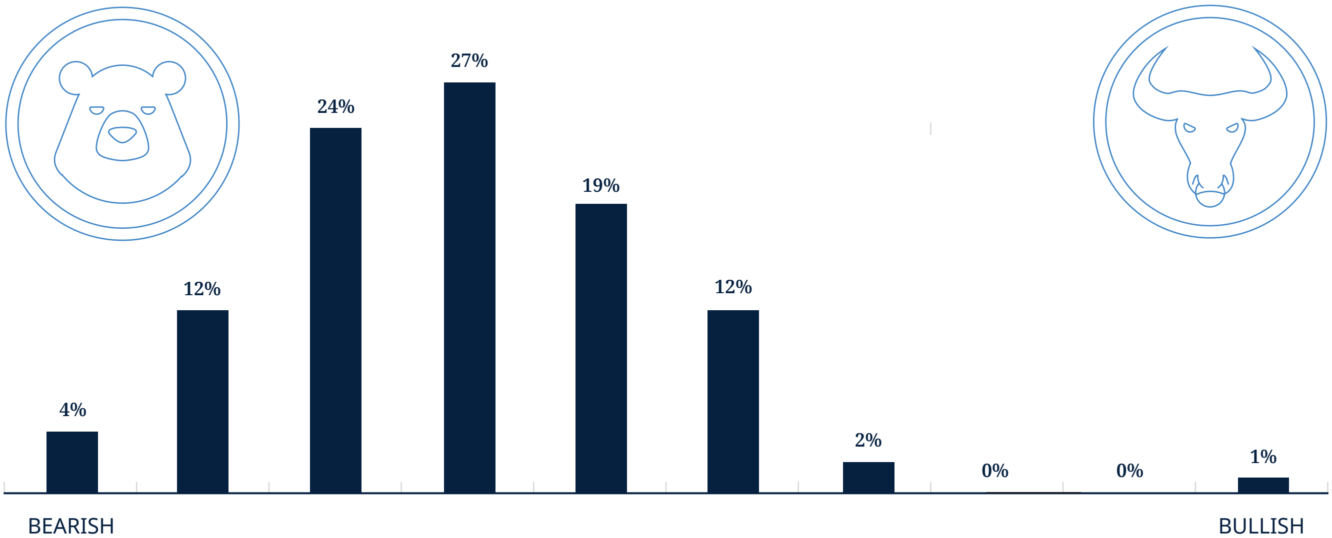
What are you most apprehensive about in the next 12 months when it comes to the commercial real estate market?

- Increase in cost of debt, equity, and property operating expenses are a focus.
- The first few months of the year have shown us that inflation is still not fully in the rearview mirror and the Fed is now forced to respond accordingly. This has implications regarding the speed at which the liquidity is prepared to re-emerge, and pricing becomes less of a stab in the dark. Until that happens, all bets are off.
- I fear that the office market will continue to erode if senior leadership fails to promote a stricter in-office policy. Hybrid is the path, but hybrid also implies some in-office/in-person work. The market needed this yesterday.
- Stagnation and decline in the health of the office market.
- Oversupply of urban multi-family.
- Decreased industrial demand.
- No liquidity for core productivity investment exits.
- Combination of significantly higher interest rates and lower or uncertain demand.
- Cyclical headwinds in all commercial real estate.
- Ongoing cost inflation combined with new momentum behind rent control in many jurisdictions.
- Interest rate increases pushing capitalization rates higher, thus damaging the values of existing held assets.
- Ability to refinance maturing loans.
- A recession's likely impact on the sector.
- Higher interest rates clearly impact returns and investment activity. At the same time, structural change, like the need for less office space as people work remotely, creates market upheaval that is simultaneous but mostly independent from capital markets issues.

- Continued interest rate uncertainty and potential for a bigger slowdown in the economy as a result thereof.
- The constraints in the debt capital markets. The overcorrection is significantly impacting fundamentally sound projects.
- No recovery in sentiment by early 2024.
- Cost of capital.
- Widespread recession risk and the capital markets freezing.
- Office, office, office!
- The amount of loans that won’t be able to get extended or refinanced, especially in the office market.
- Valuation impacts to existing real estate due to rapid rise in rates.
- Lack of available debt capital due to various bank pressures including impact on loans with office collateral.
- High construction costs.
- Cost of tenant improvements.
- Looming debt maturity and no appetite for new capital to keep assets stable. Foreclosures and challenging workouts ahead.
- Loan maturity dates for commercial property.
- Dramatic drop in office valuations. The magnitude of losses coming is not widely recognized by the market, especially the lending community, which is going to have to take significantly larger impairments/losses than they have modeled.
- The cost and availability of debt, specifically its sources.
- The constraints on debt now require more equity with diminished returns because income will not increase proportionately.
- The risk of a hard landing and further disruption of the banking system.
- Stress in regional banks, which support local real estate businesses and small investors.



1. How would you describe your outlook for the US commercial real estate market over the next 12 months, with 1-5 being bearish and 1 being the most bearish, and 6-10 being bullish and 10 being the most bullish?



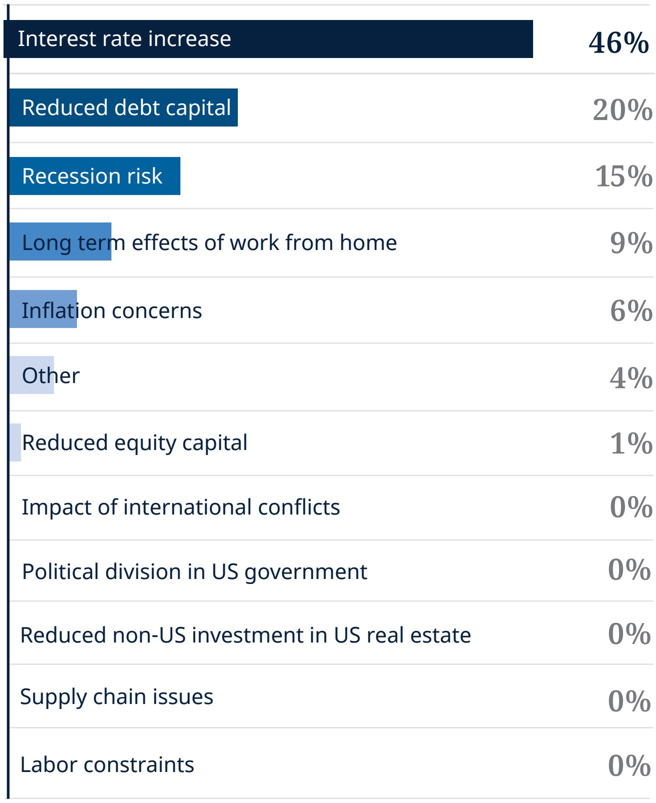
- This year's report showed that 86 percent of respondents are bearish about the next 12 months.
- This number reflects a stark shift in sentiment since our 2022 report, when 73 percent of respondents felt bullish – a result consistent with our 2021 report.
- While less than a fifth (15 percent) of respondents had a bullish sentiment, a similar amount (16 percent) had a strong bearish sentiment. The remaining respondents (69 percent) were more moderately bearish.
- There was no statistically significant difference in sentiment between those surveyed before versus after the start of the recent bank failures, pointing to a greater emphasis on other concerns that were already impacting the sector in the months leading up to the crisis.

2. What is the primary reason for your confidence?

Strong fundamentals in many asset classes	37%
Repricing/recapitalization opportunities	32%
Abundance of capital	16%
US economic outlook	11%
Real estate as an inflation hedge	5%
Non-US investment in US real estate	0%
Benefits from US government spending	0%
Other	0%

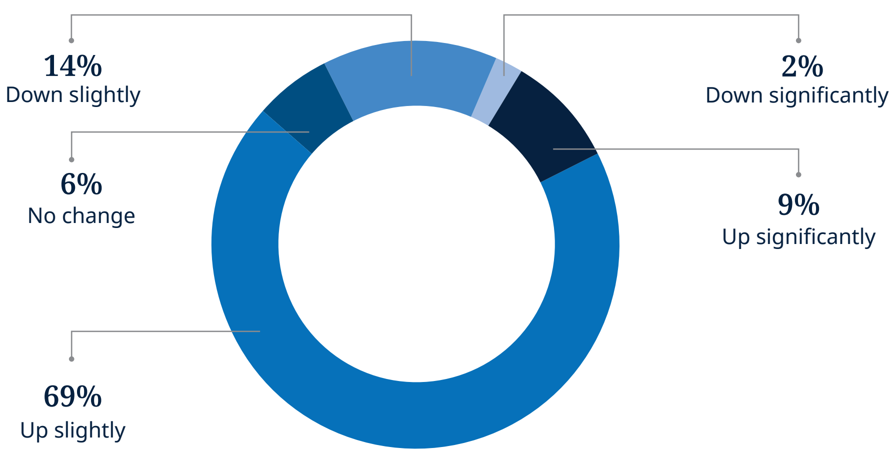
- Thirty-seven percent cited strong fundamentals in many asset classes, up 17 percentage points from last year. Sectors like medical office and grocery-anchored retail, for example, have seen a significant amount of deal activity in the last year, and are expected to remain strong, as shown in our survey.
- Last year, 52 percent cited an abundance of capital, making it the top reason for bullishness. This year, that number dropped sharply, accounting for just 16 percent of respondents.

3. What is the primary reason for your lack of confidence?



- In contrast to last year's overwhelming bullishness, nearly half (46 percent) of respondents surveyed this year cited interest rate increases as the reason for their bearishness (versus just 26 percent in 2022), making it the number-one reason for lack of confidence in 2023.
- Reduced debt capital accounted for 20 percent of respondents' lack of confidence, followed by recession risk (15 percent).
- Long-term effects of work-from-home continue to be a concern (9 percent), albeit smaller than in 2022 (15 percent), as office vacancies and repurposing of those spaces remain top-of-mind for industry leaders.

4. Where do you think interest rates are headed during the next 12 months?



- Nearly 7 in 10 (69 percent) expect interest rates to go up slightly over the next 12 months.
- Sixteen percent expect them to drop, compared to just one percent who thought the same in last year's report.
- Since the report was fielded in February and March, the Fed has announced additional interest rate hikes – though slower than in the few months prior to the survey – and has hinted at a pause in further increases. Still, the 10 hikes instituted by the Fed over the last year have left an indelible mark on decision-making across the industry.

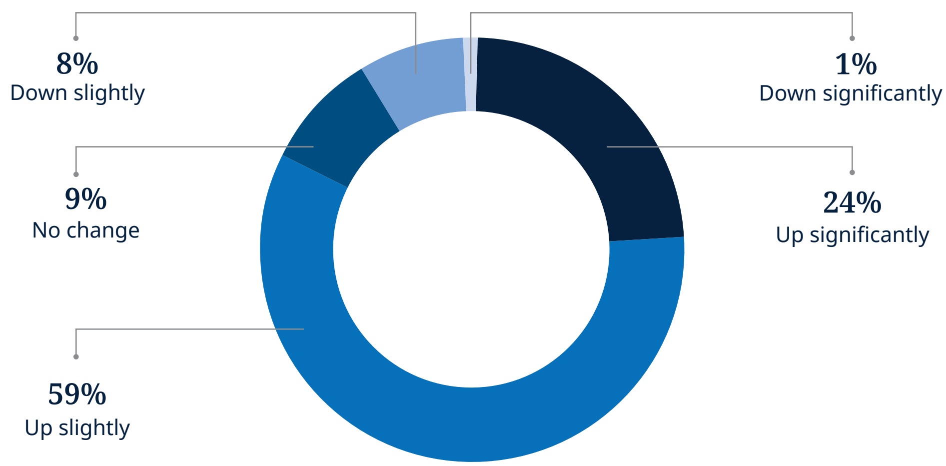
5. Please rank each of these topics on a scale of 1 to 4, where 1 means they will be "not impactful" and 4 means they will be "very impactful" on the commercial real estate market over the next 12 months.

	1 Not impactful	2	3	4 Very impactful
Interest rate changes	0%	2%	14%	84%
Challenges in refinancing existing debt	0%	2%	19%	79%
Inflation	0%	11%	32%	57%
Redesign/Reimagining use of office and other commercial spaces	6%	35%	36%	23%
Demographic/population shifts among regions	9%	35%	36%	20%
Labor constraints[1]	6%	39%	38%	17%
Geopolitical conflicts	11%	38%	37%	14%
E-commerce	14%	45%	32%	9%
Anticipated infrastructure spending	15%	46%	34%	6%
Supply chain issues[1]	13%	52%	27%	9%
Increased wealth gap[1]	32%	34%	26%	8%
Increased focus on ESG and sustainability	29%	41%	17%	13%
PropTech	32%	50%	16%	2%
Healthy workplaces (e.g., wellness initiatives)	32%	50%	15%	2%
Autonomous vehicles and drone deliveries	71%	26%	2%	1%

[1] Small base size, findings are directional.

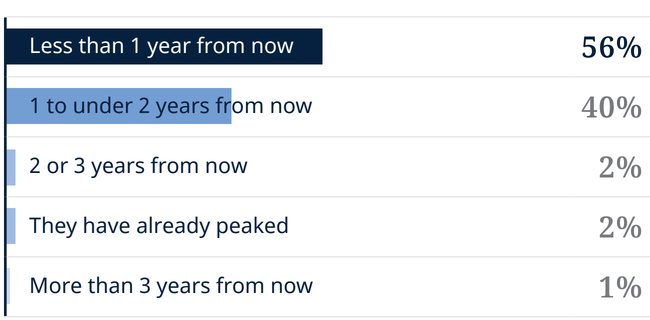
- Nearly all (98 percent) of respondents said interest rates will have an impact on the commercial real estate market, a 22 percentage-point increase from 2022.
- An equal 98 percent also cited challenges in refinancing debt as an impactful consideration for the industry – particularly noteworthy given "more than half of the $2.9 trillion in commercial mortgages will be up for refinancing in the next couple of years," according to Morgan Stanley. Meanwhile, 89 percent expect the industry to feel the impacts of inflation, and 59 percent referenced the redesign/reimagining of the use of office space and other commercial spaces.
- Less impactful considerations included an increased focus on ESG and sustainability (30 percent, down from 45 percent in 2022), PropTech (18 percent), healthy workplaces and wellness initiatives (17 percent), and autonomous vehicles and drone deliveries (3 percent).

6. Where are capitalization rates headed in the next 12 months?



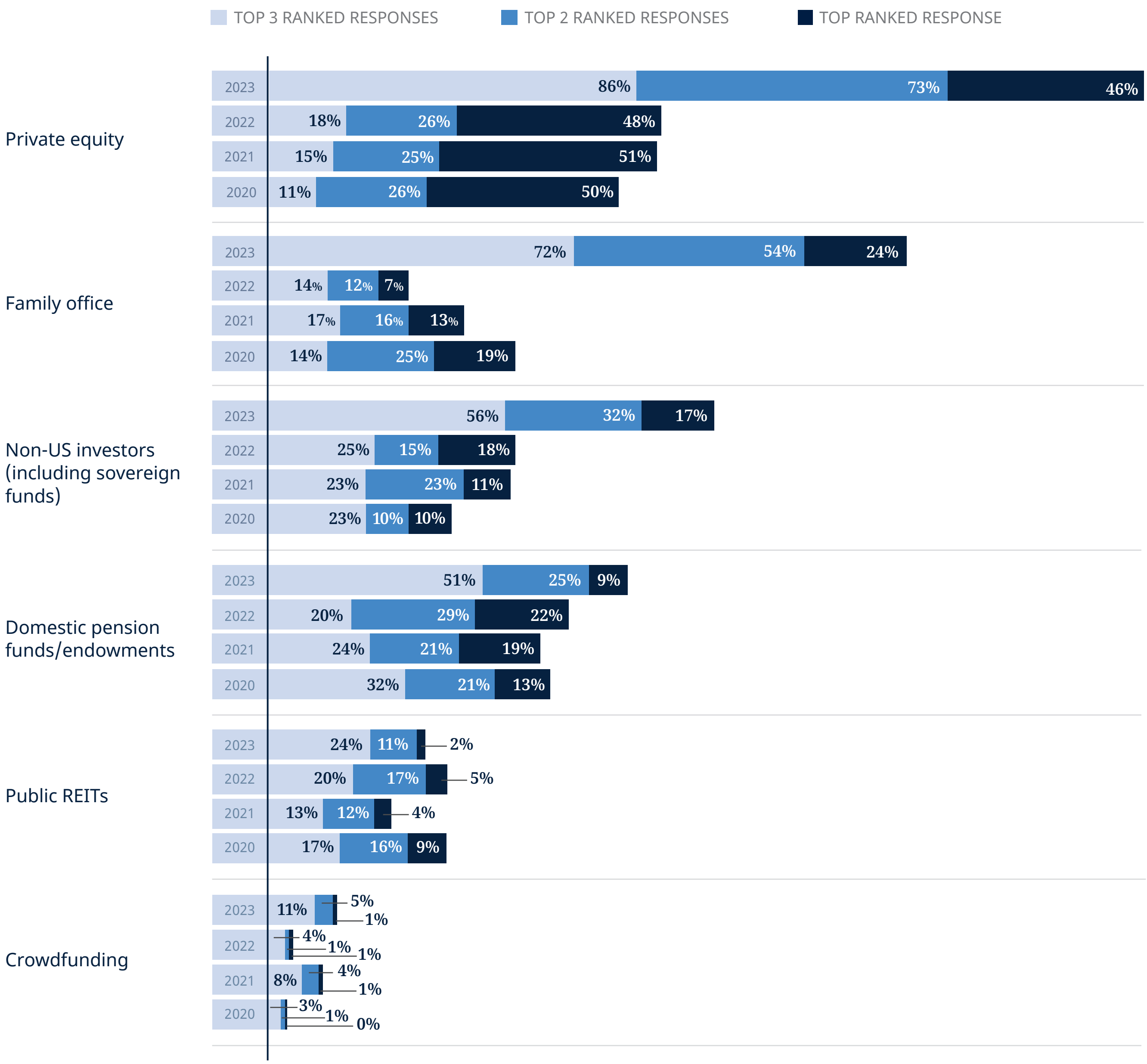
- Consistent with expectations in a bear market, 83 percent of respondents expect that capitalization rates will go up in the next 12 months, with most of that group (59 percent) anticipating only a slight increase.
- Only 9 percent expect no change, and the same percentage expect a decrease.

7. When do you think the recent increases in interest rates will peak?



- More than half (56 percent) felt that interest rate increases will peak within less than a year or already have, signaling that risks may fall in 2024 and create a more opportune environment for property deals.
- Forty percent expect interest rates will peak between one year to under two years from now.

8. What types of equity investors do you expect will be most active in the US during the next 12 months?



- Consistent with 2022, private equity remained the most common top-ranked response at 46 percent, though it became more popular as a second- and third-ranked choice, marking an overall rise in expectations for private equity. At a global level, real estate deal volume in private equity declined 20 percent in 2022, but was still the second-highest year on record, according to McKinsey.
- Family office was also a popular choice, accounting for 24 percent of top-ranked responses, 54 percent of top two ranked responses, and 72 percent of top three ranked responses.
- These responses indicate that private equity and family office holders may have more flexibility to take advantage of the current market as compared to other types of investors.

9. What will happen to real estate equity commitments in the next 12 months?

Commitments will be down slightly	47%
Commitments will be down significantly	24%
Commitments will be up slightly	16%
No change in commitments	13%
Commitments will be up significantly	0%

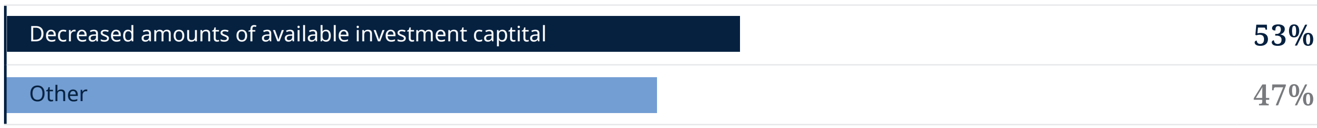
- In line with their bearish perception and expectations for a challenging market, most (71 percent) predict real estate equity commitments will go down in the next 12 months.
- Forty-seven percent of that group expects only a slight decline, while 24 percent anticipate a significant drop.
- Another 13 percent anticipate no change in the year ahead, while 16 percent expect an increase.

10a. Why do you think commitments will be up?

Large amounts of available investment capital	70%
Anticipated stabilization of interest rates	65%
Increased attractive equity investment opportunities	45%
Increased investment in real estate as an inflation hedge	30%
Flight to US as a safe haven	30%
Increased attractive debt investment opportunities	25%
Positivie US economic outlook	15%
US political, tax and/or regulatory environment favorable to real estate	5%
Other	0%

- Of the 16 percent who expect an increase, 70 percent of respondents cited large amounts of available investment capital, while 65 percent noted the anticipated stabilization of interest rates – the latter of which may be realized soon, as indicated by the Fed after its May meeting.

10b. Why do you think there will be no change in commitments?

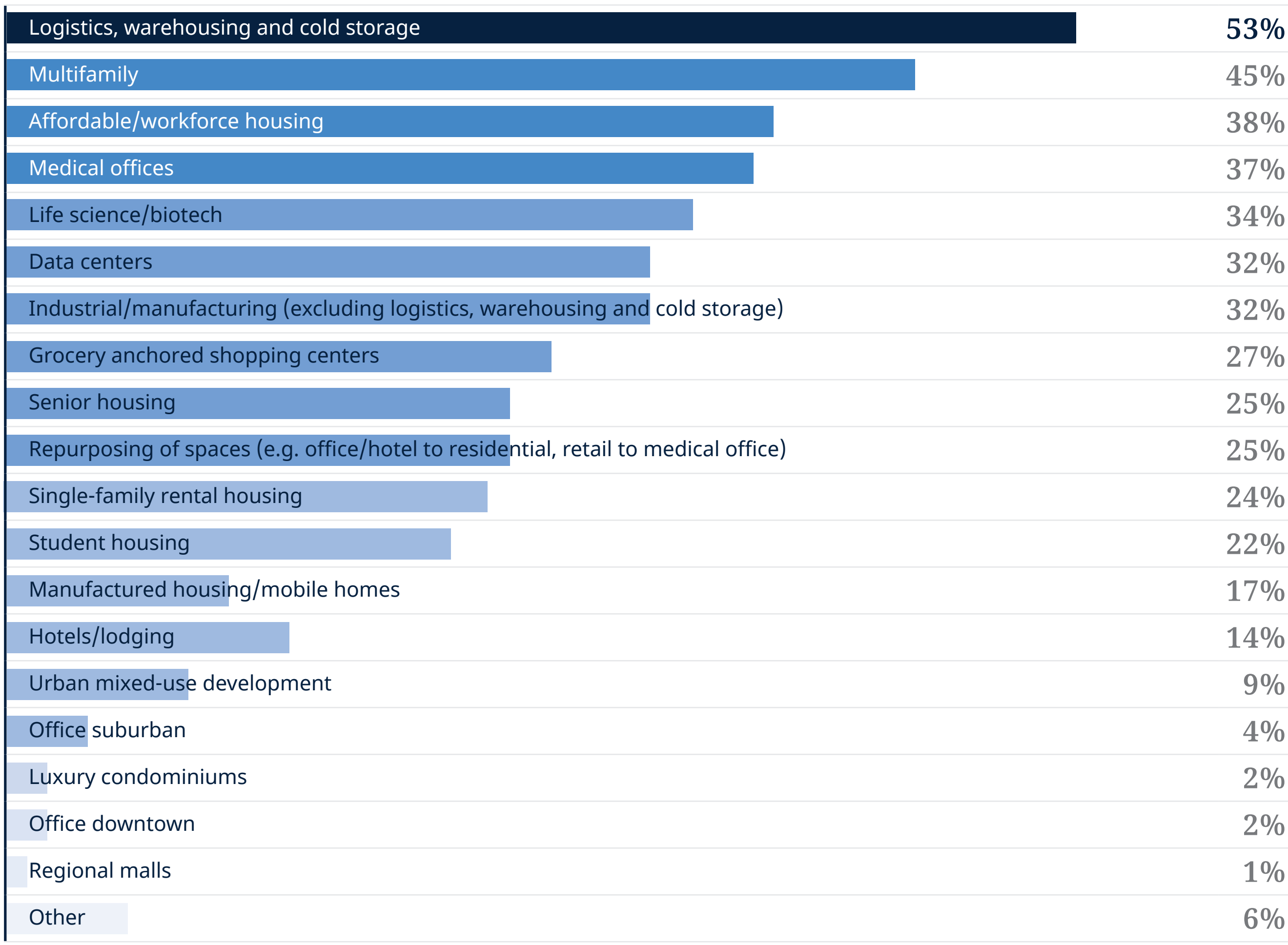


- Last year, an abundance of capital was the primary driver of bullishness; now, more than half (53 percent) of those who anticipate no change in commitments cited decreased amounts of available investment capital, while the remaining 47 percent cited "other."

10c. Why do you think commitments will go down?

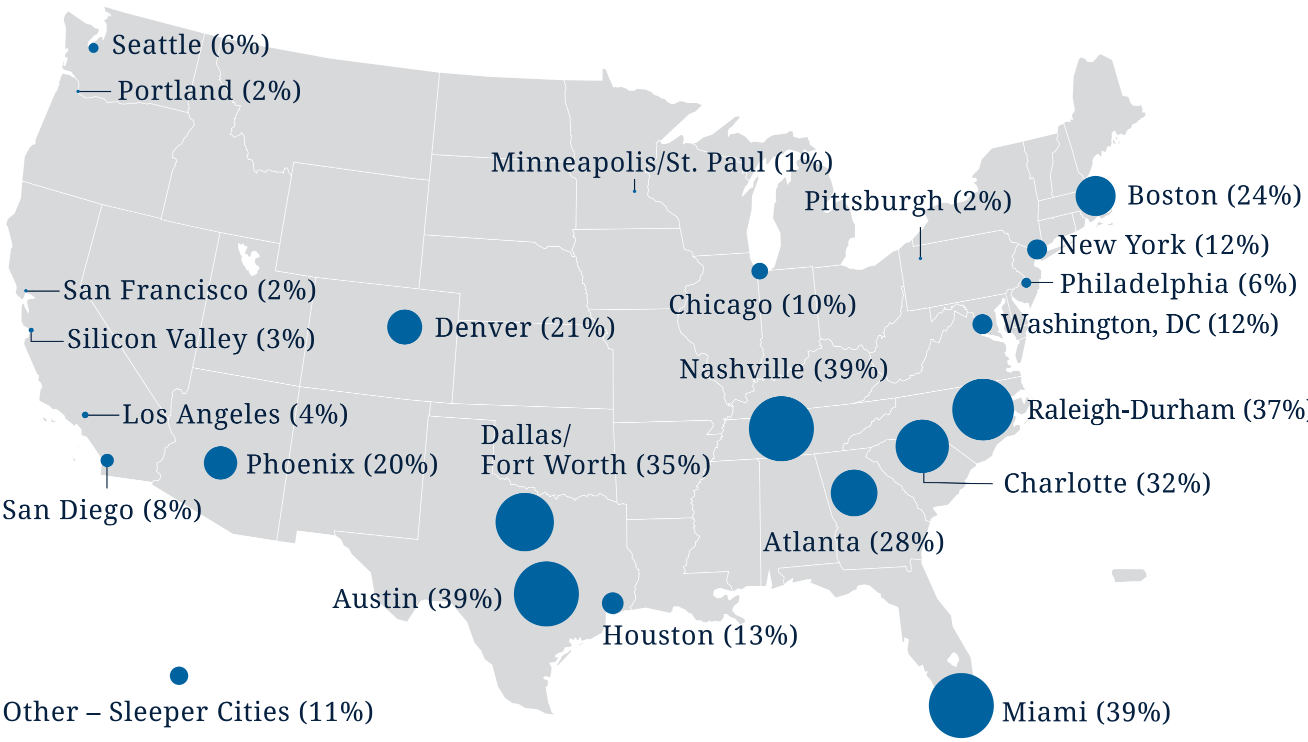
- Among those who expect commitments to decline, uncertainty around interest rates (67 percent) was the most common contributing factor, as well as an uncertain or negative economic outlook (67 percent).
- Others who forecast a decline cited inflation concerns (42 percent), decreased attractive equity investment opportunities (41 percent), and decreased amounts of available investment capital (37 percent).
- Overall, the interconnected nature of tightening financial conditions and higher interest rates, less access to capital, and broad uncertainty in the market have the majority of respondents anticipating commitments will decline.

11. Which asset classes present the most attractive, risk-adjusted opportunity in the US for real estate investors during the next 12 months?



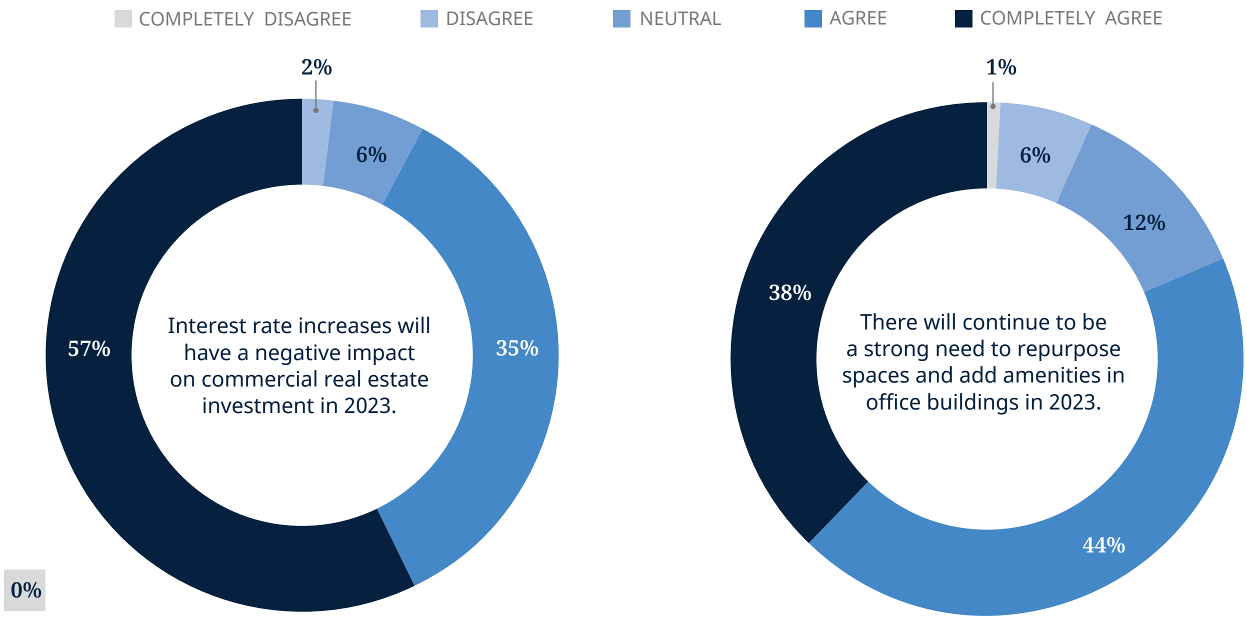
- Logistics, warehousing, and cold storage remained the top asset class among respondents, cited by 53 percent of respondents (down from 66 percent in 2022).
- Multifamily remained second on the list, referenced by 45 percent of leaders, but saw a similar drop-off (decreased from 57 percent in 2022).
- Other opportunities include affordable and workforce housing (38 percent), medical offices (37 percent), and life science and biotech (34 percent), the latter of which saw a 22 percentage-point drop compared to 2022.
- In 2022, actual investments in the US in commercial real estate were led by multifamily (45 percent), followed by industrial (21 percent) and office (16 percent). Just 2 percent of our respondents expect opportunities in downtown office in 2023.

12. Where are the top US cities for investment during the next 12 months?

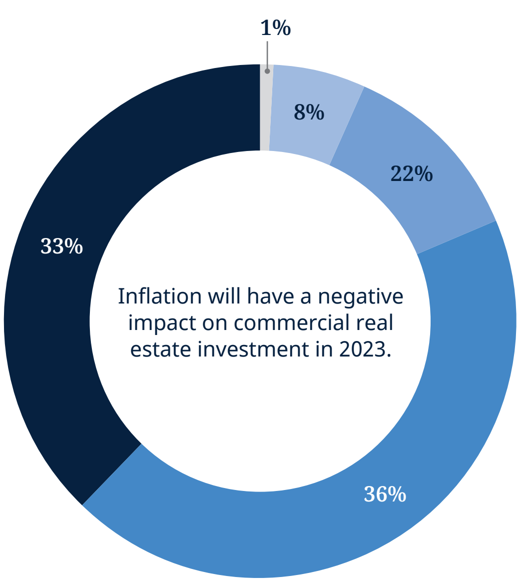


- Austin (39 percent) remained the top city for investment among respondents, though it saw a 21 percentage-point drop from 2022, as responses became more evenly distributed across the top cities.
- Nearly 4 in 10 (39 percent) named Miami as a top city (up from 27 percent in 2022), the same number identified Nashville.
- Raleigh-Durham declined slightly this year, with 37 percent of respondents naming it a top contender.

13. Listed below are statements that express a range of attitudes and opinions people may have about the commercial real estate market.



- Nine in ten (92 percent) agree that interest rate increases will have a negative impact on commercial real estate investment in 2023, as compared to just 43 percent in our 2022 report. Still, interest rates were cited as the top concern both years.
- Eight in ten (82 percent) agree that it will be important to repurpose space and add amenities, in line with broader conversations about the office sector, office-to-residential conversions, and what office buildings need to thrive in the current landscape.
- Still, challenges – like zoning laws and costly, necessary infrastructure changes for conversions – remain, and limit the ability of landlords and developers to make these updates.

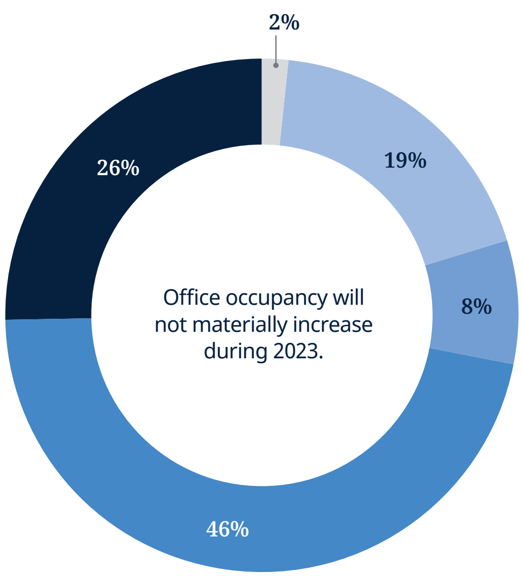


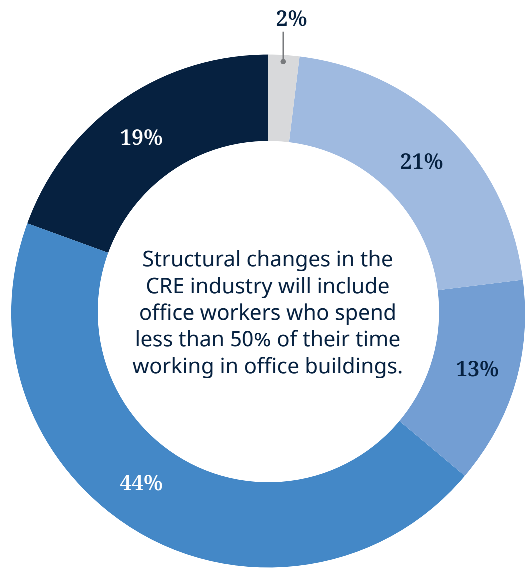
- While less of a concern for respondents than interest rates, commercial real estate leaders believe inflation remains a risk to the industry; 69 percent feel inflation will have a negative impact on investment in commercial real estate this year.
- Inflation hit a 40-year high in 2023, though it is showing signs of slowing in response to the Federal Reserve's aggressive interest rate hikes.

Content continues on next page

(continued) Listed below are statements that express a range of attitudes and opinions people may have about the commercial real estate market.

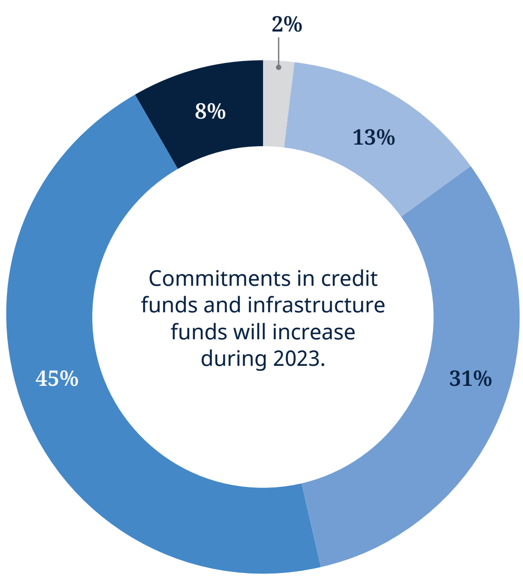
COMPLETELY DISAGREE | DISAGREE | NEUTRAL | AGREE | COMPLETELY AGREE





- Seventy-two percent agree that office occupancy will not materially increase this year, consistent with the sentiment amongst 59 percent of respondents who felt that the ongoing effects of the pandemic will have material long-term impacts on CRE in major urban areas.

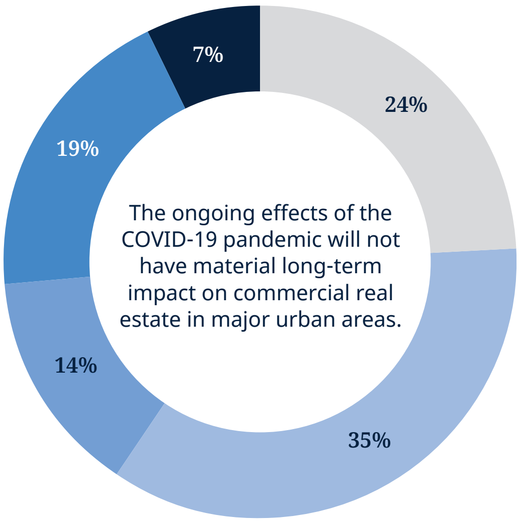
- Over half (63 percent) of those who took the survey agree that office workers spending less than half their time working in the office will be among structural changes across the industry, in step with the 82 percent of New York City employers who believe a "hybrid" schedule will be their predominant policy in 2023.

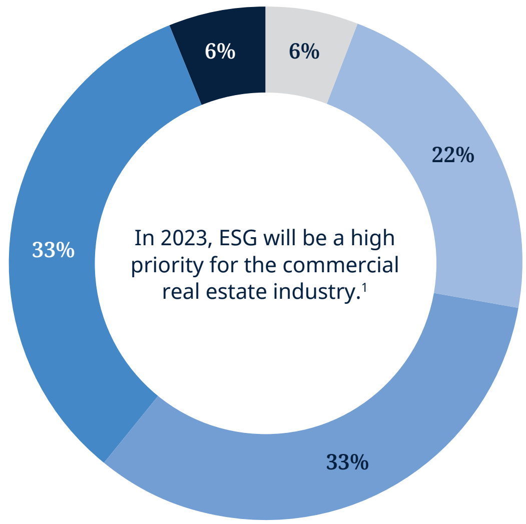


- A slight majority (53 percent) of respondents agree that there will be an increase to commitments in credit funds and infrastructure funds, though just eight percent "completely" agreed. Nearly a third (31 percent) of respondents were neutral, signaling a less certain sentiment amongst industry leaders as the picture continues to take shape.

(continued) Listed below are statements that express a range of attitudes and opinions people may have about the commercial real estate market.

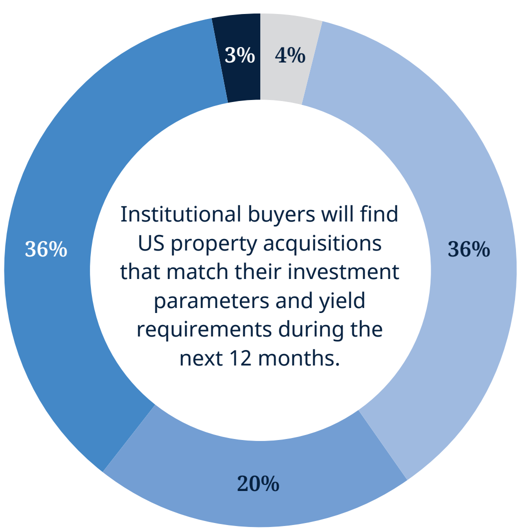
COMPLETELY DISAGREE DISAGREE NEUTRAL AGREE COMPLETELY AGREE





- Nearly 1 in 6 (59 percent) respondents feel the COVID-19 pandemic will have some type of material impact on commercial real estate in major urban areas — only a slight decrease from 62 percent in 2022. However, the number of leaders that now feel the COVID-19 pandemic will not have a material impact increased to 26 percent in 2023 (from only 16 percent in 2022) – potentially showing an increase in optimism that urban areas will be able to thrive post-pandemic.

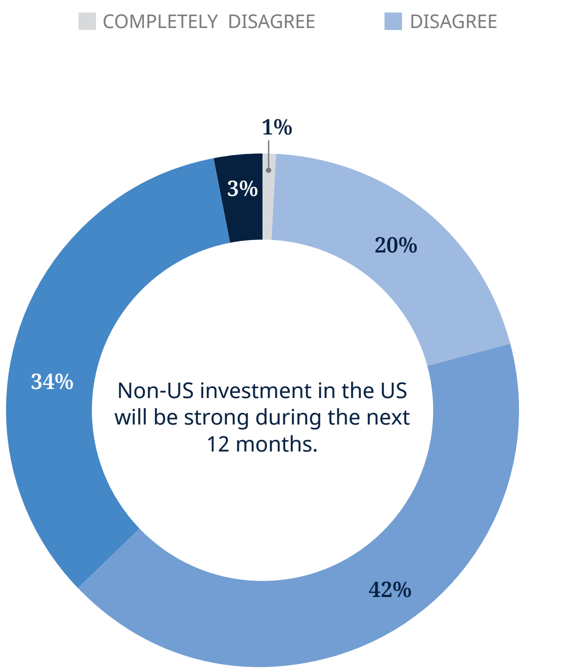
- Increasing slightly from sentiment in our 2022 report, 39 percent of commercial real estate leaders believe ESG will be a top priority for the industry this year. While stakeholder and regulatory focus on ESG impacts of the commercial real estate industry are continuing to drive this as a priority, a greater focus is still needed to deliver a noticeable impact across the market.

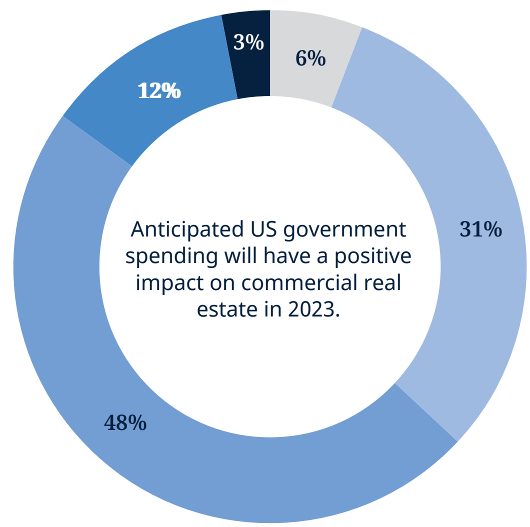


- Results were much more mixed when the survey asked whether institutional buyers will find US property acquisitions that match their investment parameters and yield requirements within the next 12 months; 39 percent agreed, 40 percent disagreed, and 20 percent remained neutral.

- While the percentage in agreement only shifted slightly between 2023 and 2022 (when 44 percent agreed), this year saw a much larger segment of respondents who disagreed, up 24 percentage points from just 16 percent in 2022.

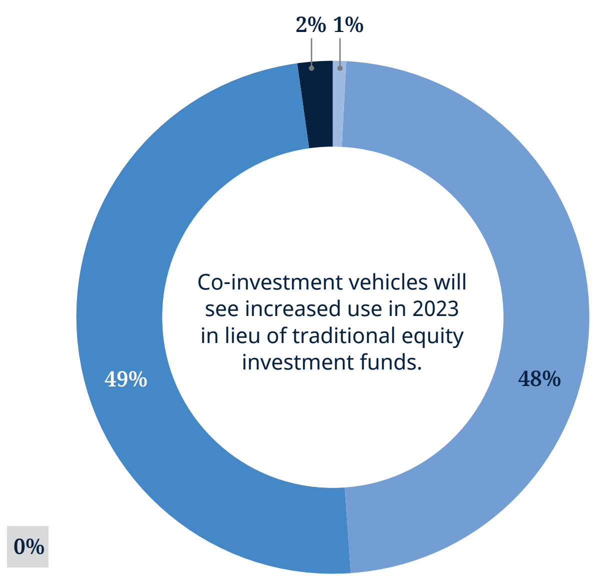
(continued) Listed below are statements that express a range of attitudes and opinions people may have about the commercial real estate market.





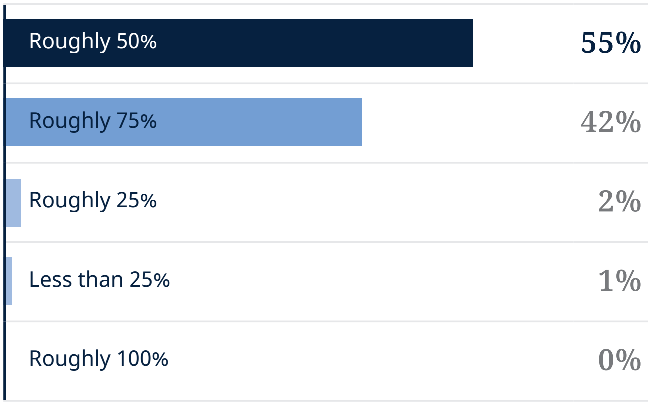
- Sentiment was also mixed on non-US investment in the commercial real estate market, with 37 percent of leaders agreeing non-US investment will be strong, and only 21 percent disagreeing. According to the Association of Foreign Investors in Real Estate (AFIRE), the US market firmly remains the most attractive market globally.

- A vast majority of commercial real estate leaders are neutral (48 percent) or disagree (37 percent) that US government spending will have a positive impact on the market. This sentiment is likely driven by continued economic concerns and the debt ceiling battle that was on the horizon when this survey was fielded – with potentially negative consequences for the commercial real estate industry and major impacts to government spending decisions.



- The role of co-investment funds in driving growth across the industry remains mixed, with leaders nearly evenly split on whether these types of investments will increase this year. However, there is a focus on co-investment strategies from organizations like the Oregon Public Employees Retirement Fund (PERF) which is expected to invest between $1.5bn and $2bn in real assets in 2023 through funds and co-investment strategies.

14. What percentage of workers in urban areas do you expect to be back in their offices consistently 12 months from now?



- Nearly 6 in 10 (58 percent) feel that 50 percent or less of workers in urban areas will return to their offices on a consistent basis over the next 12 months.
- Forty-two percent feel that roughly three-fourths of this group will consistently return to offices.
- No respondents expect a full return in the next 12 months.
- Broadly, sentiment around a return to office remained consistent with 2022 levels, though slightly less optimistic. A recent poll from Chief Executive found that the number of companies operating on-site increased by 15 percentage points between 2022 and 2023, though it remains at fewer than half (46 percent).

15. When do you anticipate US office building vacancy returning to pre-pandemic levels?

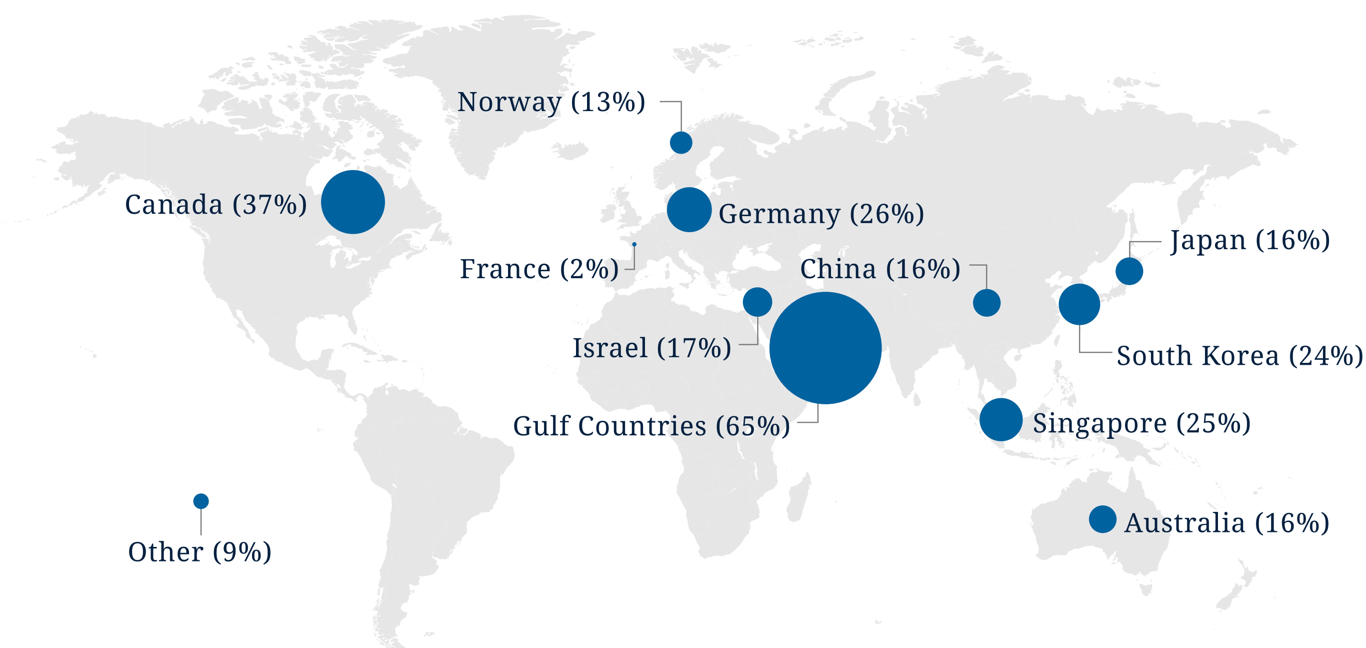
- Forty-three percent of respondents expect that US office building vacancies will never return to pre-pandemic levels, more than double the amount that felt the same in 2022 (20 percent).
- Only 21 percent forecast a return to pre-pandemic levels in the next three years.
- In major cities like New York, office vacancy rates have hit a record high in recent months; while there are pushes to repurpose office space and convert it to housing or other commercial space, things like zoning and other local policies pose hurdles.

16. Which of the following factors will have the greatest impact on the global commercial real estate market?

Interest rates	83%
US economic outlook	46%
Inflation	45%
Global economic outlook	35%
Impacts of pandemic on use of space	25%
Global political instability	25%
US relations with China	9%
US/EU relations with Russia	6%
Continuing impact of pandemic generally	5%
Climate change/ESG initiatives	4%
Other	2%

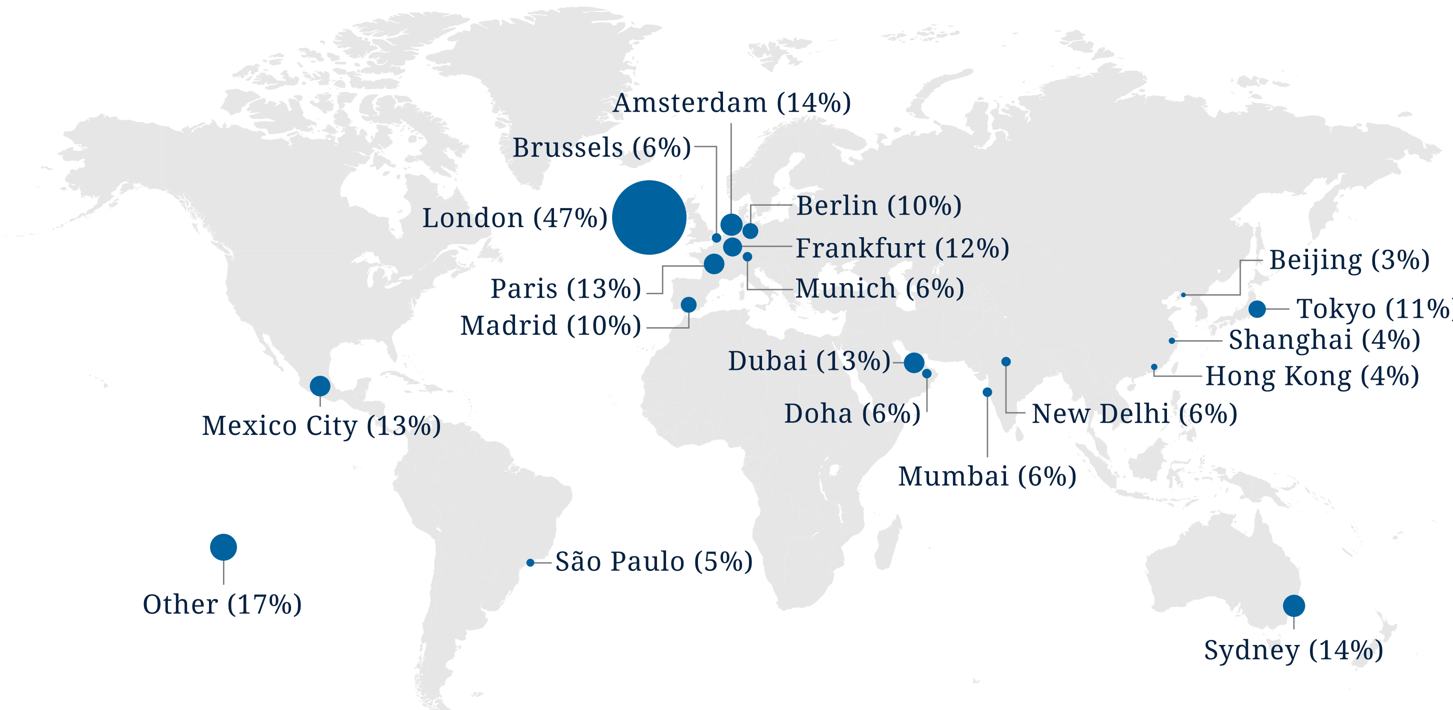
- Interest rates are expected to have the biggest impact on the global market, according to 83 percent of respondents.
- The US economic outlook was cited by 46 percent of respondents – up 7 percentage points from 2022 and compared to just 35 percent who identified the global economic outlook.
- Inflation is also expected to remain a global factor, as 45 percent of respondents anticipate it to impact the global market.
- Global political instability was a less common choice in 2023, dropping 39 percentage points since 2022.

17. Investors from which of the following countries will be most active in the US commercial real estate market during the next 12 months?



- The top response was Gulf countries like the UAE, Qatar, and Kuwait, accounting for 65 percent of responses (up 21 percentage points over 2022).
- Canada accounted for 37 percent of responses in 2023, falling from its top spot in the 2022 report.
- Germany (26 percent) also fell significantly, dropping 28 percentage points from 2022.

18. Which of the following international cities are most attractive for investment during the next 12 months?



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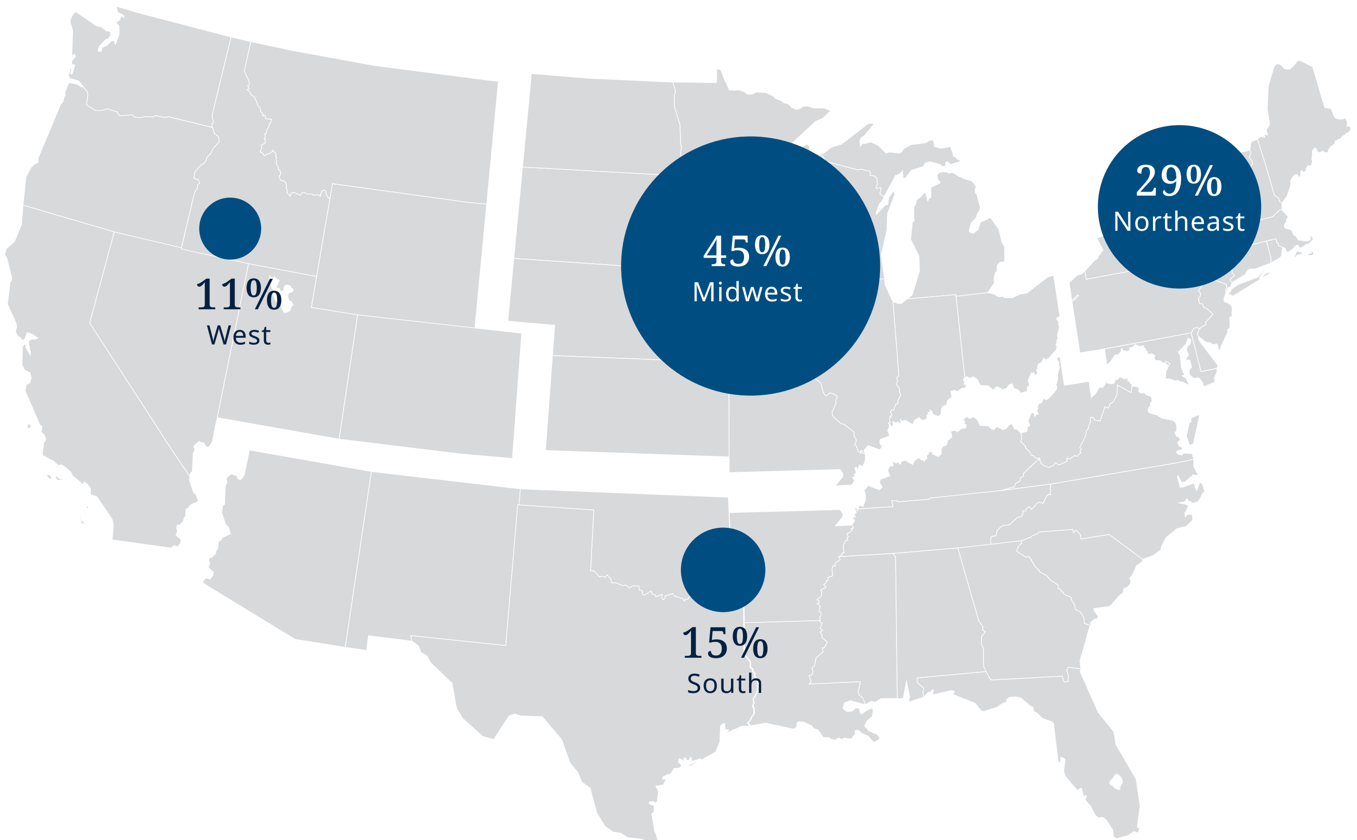
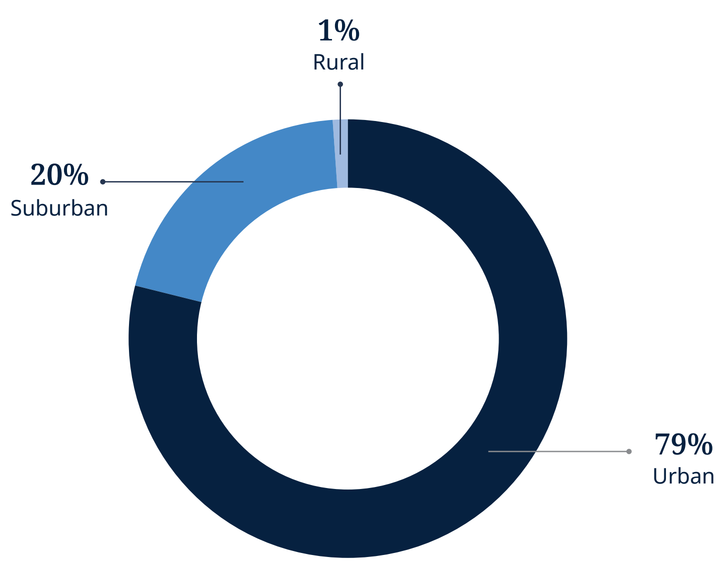
- Canada accounted for 37 percent of responses in 2023, falling from its top spot in the 2022 report.
- Germany (26 percent) also fell significantly, dropping 28 percentage points from 2022.

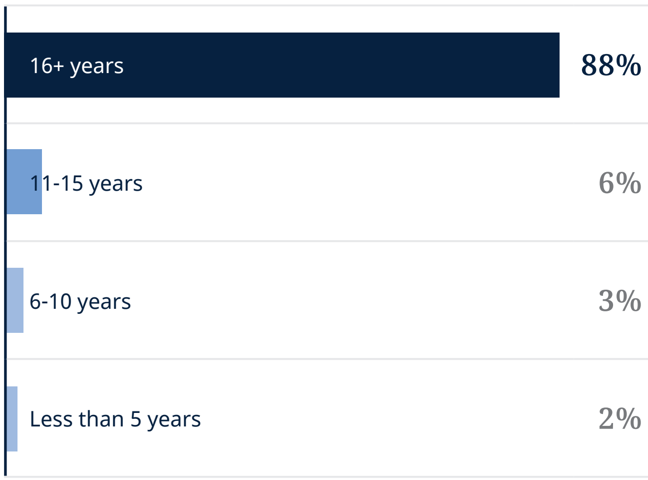
19. Where is your primary residence?



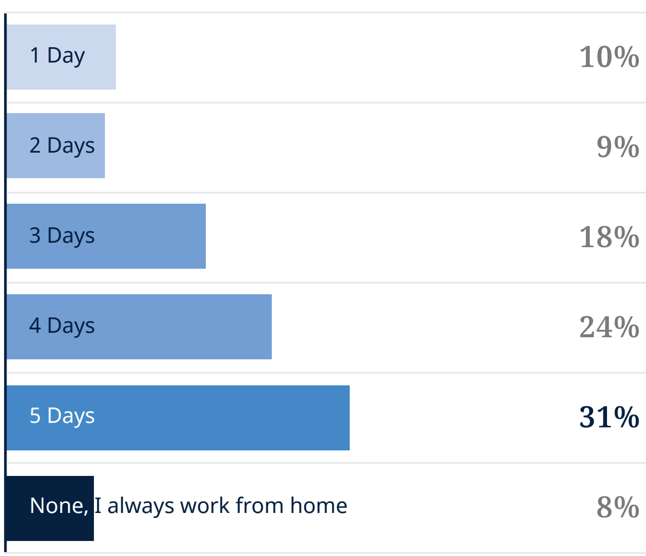
20. How would you describe the area where you work?



21. How long have you worked in commercial real estate?



22. In a typical week, how many days do you work from a physical office space outside of your home?



Methodology

Between March 3–27, 2023, DLA Piper distributed a survey to experts within the commercial real estate industry via email lists. These experts include CEOs, COOs, CFOs, real estate developers, real estate debt providers, real estate investors, third-party brokerage, property and asset managers, and other real estate professionals. The survey was completed by 128 respondents in total. Due to rounding and multi-select questions, percentages used in some of the questions may not equal 100 percent.

Endnotes

1 "DLA Piper Global Real Estate Annual State of the Market Survey," DLA Piper, May 2022

2 "Core US Inflation Rises to 40-Year High, Securing Big Fed Hike," Bloomberg, October 13, 2022

3 "Takeaways from the Federal Reserve meeting," CNN, May 3, 2023

4 "Consumer Price Index Summary," US Bureau of Labor Statistics, May 10, 2023

5 "2023: The Year The Global Supply Chain Bounces Back," Forbes, February 17, 2023

6 "U.S. office market report," Avison Young, Q1 2023

7 "Bank Failures May Cause Commercial Lending to Tighten," Realtor Magazine, March 23, 2023

8 "What's the Real Situation with CRE and Banks: Doom Loop or Headline Hype?" Moody's Analytics, April 4, 2023

9 "SWAA February 2023 Updates," Stanford University, February 12, 2023

10 "Survey of Employers," PFNYC, February 2023

11 "So You Want to Turn an Office Building into a Home," The New York Times, March 11, 2023

12 "LaSalle Street Reimagined," Chicago.gov,

13 "San Francisco Could Sweeten the Pot for Converting Empty Offices to Housing," The San Francisco Standard, January 10, 2023

14 "Where People Moved in 2022," The National Associate of Realtors, January 30, 2023

15 Blackstone's McCarthy: 'Effectively the full fund is fresh dry powder,'" Perenews, April 12, 2023

16 "Medical Office Fundamentals Remain Solid, but Cost Concerns Weigh on the Healthcare Industry," Colliers, March 24, 2023

17 "Grocery-Anchored Retail Has Another Record Year," ALM GlobSt.com, January 26, 2023

18 "2023 Seniors Housing & Care Investor Survey and Trends Outlook," JLL, January 24, 2023

19 "The offices of the future are mini towns. Workers love them," Insider, April 13, 2023

20 "American Cities Are Starting to Thrive Again. Just Not Near Office Buildings." Wall Street Journal, May 31, 2023.

21 "The Problem," The National Low Income Housing Coalition

22 "How High-Interest Rates Affect Commercial Real Estate," Point Acquisitions, May 9, 2022

About DLA Piper

With a portfolio of services to match every stage of the business lifecycle, we combine practice area knowledge with modern industry insights and an expansive geographic footprint in a way that no other firm can. Our global solutions are tailored and seamless – and ready to meet your toughest challenges.

Seamlessly executed global solutions
Our deep capabilities and broad global platform and mindset produce exceptional results for our clients around the world. We make global easy.

Trusted steward of growth and change
We help our clients manage their growth and change. Our flexible and forward-looking approach guides clients through both opportunities and risks.

Passionate community and social leader
We lead on important social, environmental, and community issues. Our people serve and make a difference.

Modern, dynamic innovator
We foster collaboration and creativity and empower our people to act. Our constant pursuit of innovation has helped transform the delivery of legal services for our clients.

Invested, collaborative partner
We are deeply integrated with our clients and essential partners in their success. Our people and our clients become one high-performing team delivering value and results.

Proven, consistent value
We earn our stellar reputation by consistently delivering exceptional services and results at a fair price across markets.

Highly Recommended
by Legal Decision Makers
BTI Consulting Most Recommended Law Firms 2022

Best of the Best
Innovative Approach
BTI Consulting 2022

Stats

40+
Countries

90+
Global offices

264
Ranked practices
Chambers Global 2022

197K+
Pro bono and community engagement hours donated globally in 2021

4,900+
Lawyers worldwide

Awards

#2
Global Elite Law Firm
Thomson Reuters 2022

#3
Global 200
The American Lawyer 2022

#2
Client Service A-Team
BTI Consulting 2022

Top 10
Most Innovative Law Firm
Financial Times 2022

DLA Piper Real Estate

Real Estate Accolades

Top Ranked
Real Estate (6 consecutive years)
Legal 500 USA 2022

Top Ranked
Land Use & Zoning (over 12 consecutive years)
Legal 500 USA 2022

Two-time Winner
Real Estate Award for Excellence
Chambers USA

2023 Real Estate News

DLA Piper is pleased to welcome New York-based partner **Stacie Trott** to the firm's Real Estate group. Stacie will act as the Co-Chair of the firm's New York Real Estate Practice and as the Co-Chair of the firm's Global Real Estate Practice. Stacie focuses her practice on highly structured corporate and commercial real estate transactions, with an emphasis on European and Asian cross-border matters. She advises institutional private equity firms, global investment managers and real estate investment funds in complex joint ventures, acquisitions, dispositions and financings of office, hotel, multi-family, logistics, industrial, storage and retail assets.

The Real Estate group also welcomes **Mike Rechtin** as partner in our Chicago office. With more than thirty years of practicing real estate law, Michael works at the intersection of real estate and technology. Mike has more than thirty years of sophisticated and broad-based real estate experience representing clients in buying, selling, developing, leasing and financing real estate assets in all asset classes. Since 2010, he has been at the forefront of the expanding, multi-disciplinary data center, digital infrastructure and IT commercial contracting fields that straddle real estate and technology.

In 2023, we promoted **Skyler Anderson** to Partner in our San Diego office, **Brian Winterhalter** to Partner in our Reston Office, **Andrew Brady** to Of Counsel in our Los Angeles office and **Eric Skeffington** to Of Counsel in our Boston office.

Stats

500+
Real Estate Global Timekeepers

160+
US Real Estate Timekeepers

38
Ranked Attorneys
Chambers USA 2023

14
Group Rankings
Chambers USA 2023

17
Real Estate Office Locations in the US

"The real estate attorneys at the firm are some of the most responsive and service-oriented in the industry."

— Chambers USA

Notable 2023 Matters

- **Hyundai Engineering** in connection with the construction of a US$5.5 billion state-of-the-art electric vehicle and battery manufacturing facility for Hyundai Motor Group at a 2,923-acre megasite located in Bryan County, Georgia. Our team advised on the non-contentious aspects of the initial stages of the project, including the drafting and negotiation of key subcontractor agreements, the construction of on-site facilities, etc. We have also consulted on claims and other issues that have arisen during construction.
- Developer **1HWY1** in a unanimous 7-0 vote by the San Diego Port commissioners to move forward with an environmental review of a US$3.6 billion plan to remake Seaport Village and the surrounding waterfront, culminating six years of planning on one of the single biggest projects in port history.
- **Soloviev Realty Group** in connection with the US$1.6 billion disposition of a five property NYC multi-family portfolio on the Upper East Side of Manhattan.
- **Harrison Street Real Estate** in connection with an acquisition/joint venture (US$1.2 billion enterprise valuation) with American Campus Communities of a portfolio of public-private-partnership (P3) student housing facilities located on Arizona State University's campus.
- **LEGO** in a program to invest over US$1 billion to build its first US toy manufacturing facility near Richmond, Virginia. Our work included representing LEGO in the site selection process for the 1.7 million-square-foot, carbon neutral factory, negotiating incentives agreements with state and local governments valued at more than US$200 million, and negotiating purchase and sale and lease agreements, development agreements, agreements with local energy providers, and construction and design documents.
- **Real estate investment management company** in connection with the financing and purchase of a US$267 million 10 floor office building located in Minami-Aoyama, Minato-ku, Tokyo, Japan.
- **A global investment manager** focused on forestland in connection with the US$214 million sale of over 94,000 acres of timberlands located in 5 counties in Arkansas to a German asset management company and the negotiation of the investment management agreements for said timberlands. Our client currently manages the assets, coordinated the sale and will continue to manage the assets for the real estate fund via the new management agreements.
- **The Tennessee Titans** in the development of its new NFL Stadium in Nashville, TN. Work includes negotiating the Design and Construction Contracts, as well as various definitive agreements between the Titans and governmental stakeholders, including a Lease Agreement, Development Agreement, Non-relocation Agreement, Construction Funds Trust Agreement and Site Coordination Agreement. The Titans, with our assistance, are coordinating with the governmental authority on the development of an entertainment venue adjacent to the stadium and a mixed-use development that will be developed by a third-party developer on the surrounding 90-acre site that encompasses the stadium.
- **Timberline Real Estate Partners** and **Origami Capital Partners** in a unanimous 9–0 Loudoun County Board of Supervisors approval of the Rivana rezoning application. Rivana at Innovation Station is an ambitious, 6.4 million square-foot master-planned development 15 years in the making. Loudoun approved 2,700 apartments, 2.4 million ft.^{2} of office, 495,000 ft.^{2} of hotel and 350,000 ft.^{2} of retail.

Contacts

Global Leadership

John Sullivan
Chair, US Real Estate
Co-Chair, Global Real Estate Sector
Co-Chair, US Real Estate Sector
Boston
T +1 617 406 6029
john.sullivan@us.dlapiper.com

Stacie Trott
Co-Chair, Global Real Estate Practice
Co-Head, New York Real Estate Practice
New York
T +1 212 335 4860
stacie.trott@us.dlapiper.com

William Naunton
Co-Chair, Global Real Estate Practice
London
T +44 207 153 7065
william.naunton@dlapiper.com

Susheela Rivers
Co-Chair, Global Real Estate Sector
Office Managing Partner, Hong Kong
Head of Real Estate, Asia Pacific
Hong Kong
T +852 2103 0760
susheela.rivers@dlapiper.com

Jo Owen
Co-Chair, Global Real Estate Sector
Global Co-Chair, Hospitality and Leisure
London
T +44 (0)7968 559 031
jo.owen@dlapiper.com

State of the Market Committee

Barbara Trachtenberg
Co-Vice Chair, US Real Estate Practice
Boston
T +1 617 406 6011
barbara.trachtenberg@us.dlapiper.com

Paul Shadle
Partner
Chicago
T +1 312 368 3493
paul.shadle@dlapiper.com

US Leadership

John Sullivan
Chair, US Real Estate
Co-Chair, Global Real Estate Sector
Co-Chair, US Real Estate Sector
Boston
T +1 617 406 6029
john.sullivan@us.dlapiper.com

Kerry E. Johnson
Co-Chair, US Real Estate Sector
T +1 312 368 2168
kerry.johnson@us.dlapiper.com

Richard Klawiter
Co-Vice Chair, US Real Estate Practice
Chicago
T +1 312 368 7243
richard.klawiter@us.dlapiper.com

Barbara Trachtenberg
Co-Vice Chair, US Real Estate Practice
Boston
T +1 617 406 6011
barbara.trachtenberg@us.dlapiper.com

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We will release our Trends Report early in Q3!